June 5, 1987

MAY 1987 MONTHLY REPORT

Monitoring Economic Change Program

Surveys of Consumer Attitudes • Economic Outlook USA

INTEREST RATE EXPECTATIONS JUMP

- In the May 1987 survey, the Index of Consumer Sentiment was 91.1, down from 92.8 one month earlier, and 94.8 one year earlier. The May survey recorded significant increases in interest rate expectations. Thus far, the expected increases in interest and inflation rates have resulted in somewhat less favorable financial expectations, and have had a mixed impact on buying attitudes.

- Among families with incomes of $30,000 or more the Index slid to 97.7 in May, from 98.5 one month earlier, and 105.5 one year earlier. During the past year, the overall decline in sentiment has been more pronounced among higher than among lower income families. Among families with incomes of under $30,000, the Index was 87.1 in May 1987, nearly identical with the 87.7 recorded one year earlier.

- Interest rates were expected to increase during the year ahead by 71 percent of all families in the May 1987 survey, significantly above the 57 percent one month earlier, and nearly twice the 37 percent recorded at the start of the year. The last time interest rates were expected to increase by as many consumers was in March 1980, when credit controls were announced. At 71 percent, the May reading ties the highest proportion ever recorded to expect interest rate increases—first reached in November 1978 and again in March 1980.

- The inflation rate expected during the year ahead has also increased in recent months. In the May 1987 survey, consumers expected prices to increase at an annual rate of 4.7%, up from 3.7% one month earlier, and 3.4% one year earlier. The proportion of families that expect price increases of 5% or more has rise to 39 from 28 percent during the past year, while the proportion of families that expect no price increases has fallen to 15 from 31 percent.

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The recent survey indicates the high degree of responsiveness of consumers to expected trends in interest rates. Their initial reaction has thus far been to lower favorable assessments of purchase conditions, but few consumers find the current level of interest rates a cause for postponement. Indeed, more consumers find cause to speed up purchase plans to avoid higher future rates. Such a reaction to temporary increases in interest rates, as occurred in the early part of this expansion, led to small but not cumulative declines in sales, as consumers acted to shift the timing of purchases. Sustained increases in interest rates over a protracted period, however, now represent a significant possibility, and the most serious threat to the sales outlook.

Although consumer optimism has all but disappeared, consumer pessimism has not risen in its place. Rather, consumer confidence has been anchored by the expectation of little sustained change in either direction. Recent increases in the expected rate of inflation, coupled with smaller expected income increases, have led the majority of consumers to expect no net change in their financial situation during the year ahead. While this is a more cautious outlook, it is not negative, as very few consumers expect their financial situation to worsen. Consequently, while such personal financial assessments do not provide support for spending increases, neither do they provide the premise for sharp spending cutbacks. This does, however, focus consumer spending decisions on the affordability of purchases, given little expected growth in real incomes. And it focuses evaluations of buying conditions on the availability of discounts.

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Personal Financial Prospects Dimmed by Inflation

Consumers' assessments of their current financial situation have changed very little during the past year. In the May 1987 survey, 43 percent of all families reported that their financial situation had improved, just ahead of the 42 percent in the survey conducted one year earlier. In both surveys, the same proportion of families reported receiving income increases (32 percent), and the same proportion complained about rising prices (11 percent).

In contrast, when asked about the year ahead, families in the May 1987 survey were less optimistic that a year ago, with the proportion that expected their financial situation to improve falling to 32 from 40 percent. Importantly, the proportion of families that expected their finances to worsen has not increased, remaining at 11 percent. The proportion of families that expect increases in their nominal income has not changed much during the past year, but the size of the expected increase has declined. And given the expected increase in inflation, real income expectations have weakened.

Buying Attitudes Respond To Interest Rates

Favorable attitudes toward buying conditions for homes were held by 77 percent of all families in the May 1987 survey, down from 82 percent one month earlier, and 83 percent one year earlier. The proportion of families that mentioned the current availability of low mortgage rates fell to 50 in May 1987, from 76 percent one year earlier (see Table A). Partially offsetting this decline, a rising proportion of families thought that current mortgage rates were favorable insofar as they were only expected to be higher in the future. The appeal of borrowing-in-advance of rising mortgage rates was mentioned by 16 percent of all families in the May 1987 survey, up from just 4 percent one year earlier (see Table A and Chart A). In contrast, the appeal of buying-in-advance of rising home prices has increased only marginally, to 9 percent in May 1987, from 3 percent one year earlier.

Vehicle buying conditions were viewed favorably by 67 percent of all families in the May 1987 survey, just above the 64 percent recorded in April, but below the year earlier reading of 75 percent. Favorable references to the availability of discounted interest rates on vehicle purchases fell to 37 percent in May 1987, from 57 percent in May 1986. And unlike the reaction of consumers to rising mortgage rates, very few consumers reported the appeal of borrowing-in-advance of rising interest rates—just 3 percent in May 1987, up from 1 percent in 1986 (see Table A and Chart B). This reaction suggests that consumers expect that discounted interest rates will continue to be offered by vehicle manufacturers, and that these rates are not expected to significantly increase in the months ahead. Interestingly, there was a somewhat larger increase in the proportion of families in the May survey that reported the advantage of buying-in-advance of rising vehicle prices, moving to 13 percent in May 1987 from 6 percent one year earlier. In addition, complaints about high vehicle prices have risen to 15 from 10 percent during the past year. Despite this slippage, favorable views of prices for vehicles were still the most common assessment in the May 1987 survey, reported by 27 percent of all families.

Favorable attitudes toward buying conditions for large household durables were held by 76 percent of all families in the May 1987 survey, just above the 74 percent recorded one month earlier, and the 75 percent recorded one year earlier. These very favorable attitudes were based on the availability of price discounts, reported by 33 percent of all families both this May and last. In addition, the appeal of buying-in-advance of rising prices has increased during the past year, rising to 20 from 12 percent. In the May survey, references to the availability of lower interest rates on purchases of household durable goods fell to 16 from 30 percent.

Majority Expect Unchanged Business Conditions

The proportion of families that thought the economy had improved during the prior year fell to 43 percent in May 1987, from 54 percent one year earlier. And nearly as many respondents expected the national economy to improve as to worsen during the year

ahead (22 versus 20 percent). Importantly, however, the majority of respondents expected the performance of the national economy to be unchanged during the year ahead (57 percent). And the majority expected this to mean the continuation of good times financially in the economy as a whole during the year ahead (51 percent in May 1987, down from 60 percent in 1986). Over the longer run, however, the more common expectation was that an economic recession was likely to occur during the next five years, by the margin of 47 to 36 percent.

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The May 1987 survey was conducted between April 30 and May 29, 1987, and included 651 completed interviews.

CHART A - HISTORICAL SERIES

REASONS FOR OPINIONS ABOUT BUYING CONDITIONS FOR HOUSES

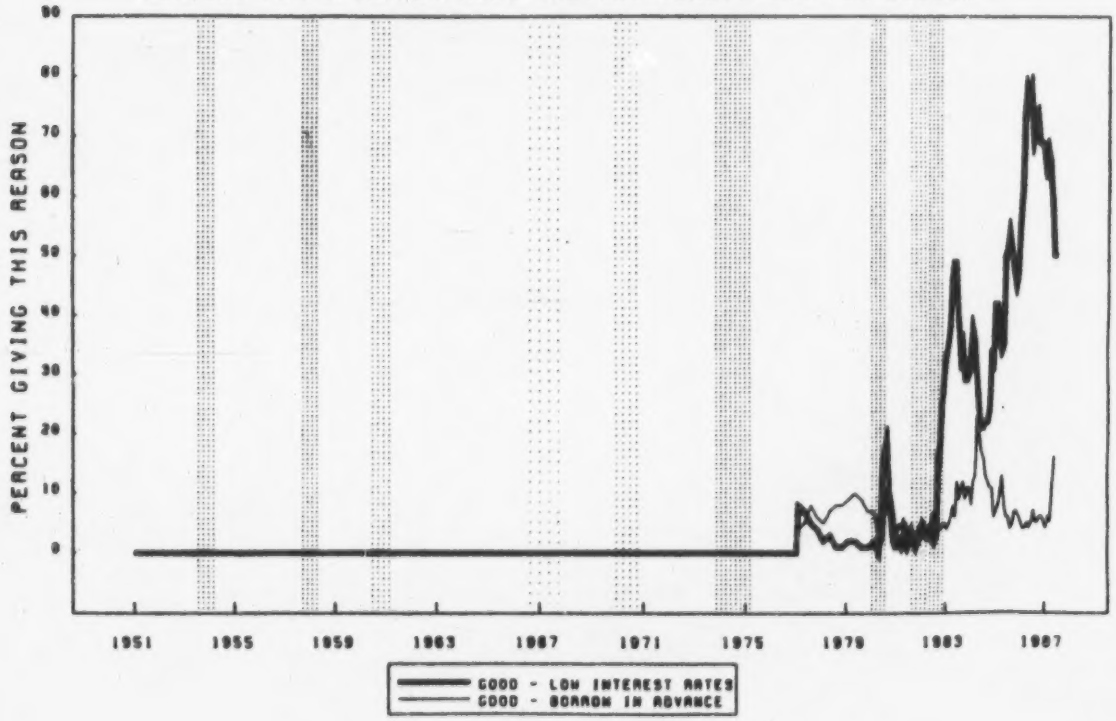

CHART B - HISTORICAL SERIES

REASONS FOR OPINIONS ABOUT BUYING CONDITIONS FOR CARS

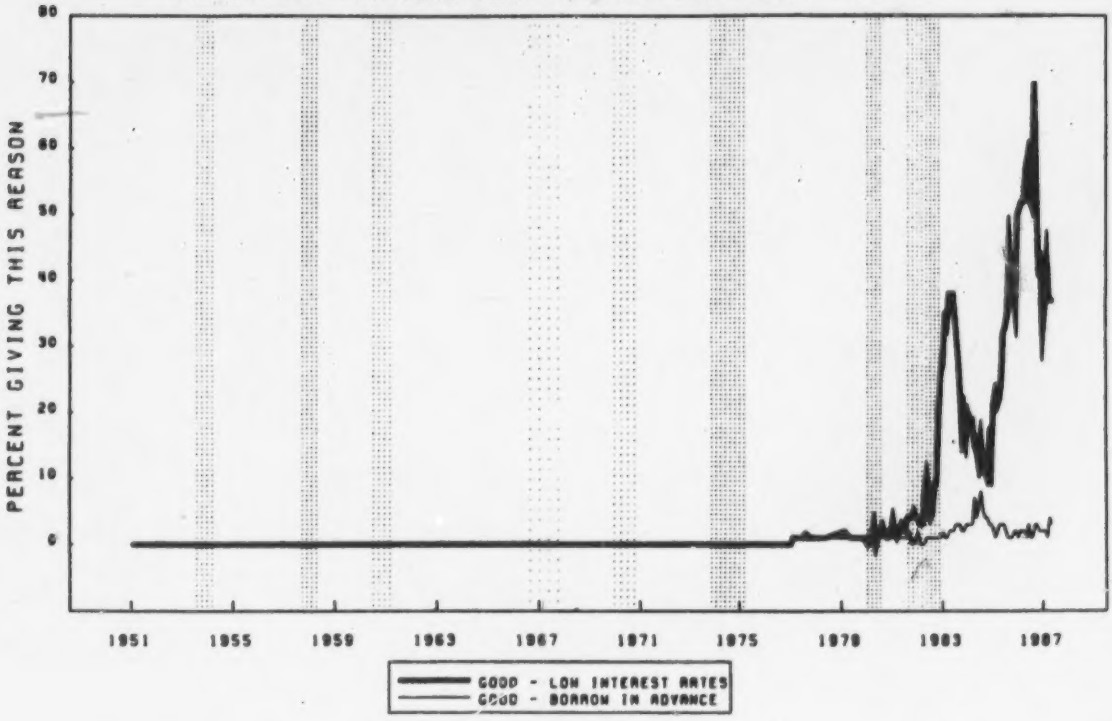

CHART C - HISTORICAL SERIES

REASONS FOR OPINIONS ABOUT BUYING CONDITIONS FOR DURABLES

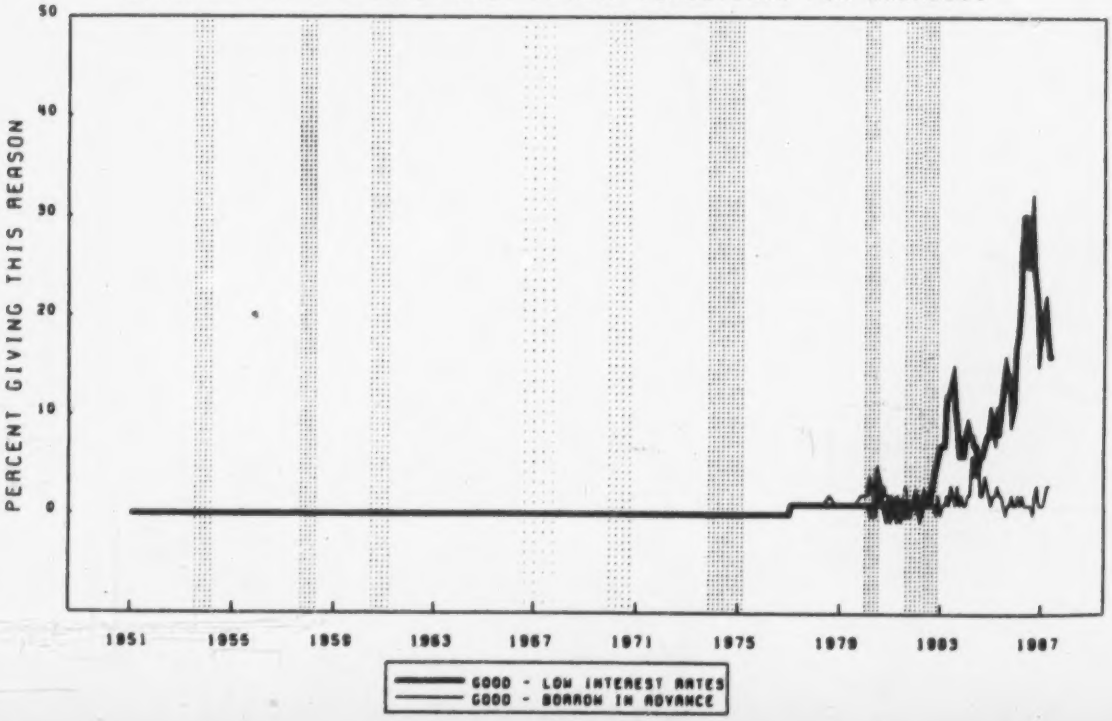

TABLE A

REFERENCES TO INTEREST RATES IN SUPPORT OF FAVORABLE BUYING CONDITIONS

Survey Date		Durables		Houses[a]		Vehicles	
		Low Rates	BIA[b] Rates	Low Rates	BIA Rates	Low Rates	BIA Rates
January	1983	7%	*	33%	4%	27%	2%
February	1983	7	1	35	5	34	1
March	1983	7	1	38	6	33	1
April	1983	12	2	46	8	38	2
May	1983	12	1	49	6	38	2
June	1983	13	3	49	12	38	2
July	1983	14	2	40	9	34	3
August	1983	11	1	33	11	30	3
September	1983	9	3	35	12	25	3
October	1983	6	1	29	9	17	2
November	1983	6	2	29	11	20	2
December	1983	6	1	30	11	16	3
January	1984	8	1	33	8	20	3
February	1984	9	2	38	12	19	3
March	1984	8	2	36	13	19	3
April	1984	8	6	29	23	15	7
May	1984	7	4	24	20	14	4
June	1984	7	4	21	17	12	6
July	1984	5	5	21	16	16	8
August	1984	6	2	22	13	12	5
September	1984	6	2	22	12	11	4
October	1984	7	4	24	11	10	4
November	1984	8	3	33	11	15	3
December	1984	8	2	32	6	12	3
January	1985	10	1	42	7	21	2
February	1985	9	2	42	8	23	1
March	1985	8	2	38	10	21	2
April	1985	10	3	34	13	22	3
May	1985	9	2	35	8	25	3
June	1985	11	2	50	6	32	3
July	1985	13	1	51	6	33	2
August	1985	15	*	54	4	35	1
September	1985	14	1	51	5	45	1
October	1985	14	1	48	7	40	1
November	1985	10	2	45	7	38	2
December	1985	11	1	47	6	35	2
January	1986	17	1	55	5	50	1
February	1986	18	2	60	4	51	2
March	1986	21	1	73	4	52	2
April	1986	27	2	78	5	52	2
May	1986	30	1	76	4	57	1
June	1986	30	1	78	5	59	3

REFERENCES TO INTEREST RATES IN SUPPORT OF FAVORABLE BUYING CONDITIONS(Cont'd)

Survey Date		Durables		Houses[a]		Vehicles	
		Low Rates	BIA[b] Rates	Low Rates	BIA Rates	Low Rates	BIA Rates
July	1986	25%	1%	70%	7%	52%	1%
August	1986	25	1	73	5	51	1
September	1986	29	*	74	5	70	3
October	1986	24	2	69	6	55	3
November	1986	22	3	69	6	42	2
December	1986	17	1	68	5	43	2
January	1987	19	1	65	4	32	2
February	1987	20	1	68	6	36	2
March	1987	21	2	66	5	43	1
April	1987	18	3	60	11	37	4
May	1987	16	3	50	16	37	3

*Less than 0.5 percent.

[a]Also includes homes, home repairs and real estate.

[b]The proportions given above provide greater detail than is reported in the monthly tables (see Tables 22, 24 and 26). The figures above divide the total proportion of respondents that made favorable references to credit conditions into those respondents that referred to the current availability of *low interest rates*, and those that referred to *borrowing-in-advance* (BIA) of rising interest rates.